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No. 90-___

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

C.L. GRIMES,

Petitioner,

v.

CENTERIOR ENERGY CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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October 22, 1990

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QUESTION PRESENTED

If a stockholder wants to bring a proposal before his fellow stockholders for their vote at the corporation's annual meeting, the SEC's rules require management to include the proposal, a supporting statement, and a proxy ballot in the proxy materials for the meeting unless, *inter alia*, the proposal "deals with a matter relating to the conduct of the ordinary business operations" of the corporation.

Did the court below err in holding that under this exception management can exclude from the proxy materials all mention of a proposal to reallocate authority as between the directors and the stockholders, if there are any circumstances under which an ordinary business action might be taken under the proposed new corporate governance?

PARTIES TO THE PROCEEDING

The names of all parties appear in the caption of the case.

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CENTERIOR ENERGY CORPORATION,

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

C.L. Grimes respectfully petitions the Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in this proceeding on July 27, 1990.

Two matters of fundamental importance—stockholder democracy and corporate governance—converge in this case. Under the reasoning of the court below, relatively few stockholder proposals dealing with corporate governance could ever be brought before the stockholders for their informed consideration. This Court has not hitherto addressed the SEC's stockholder proposal rules in any fully litigated case, and corporate governance is a lively issue and one

likely to become livelier still; we respectfully suggest that this Court's guidance is thus appropriate and timely.

I. PRELIMINARY MATTERS

A. Opinion Below

The opinion of the court below is reported at 909 F.2d 529 (D.C. Cir. 1990), and at FED. SEC. L. REP. (CCH) ¶ 95,391. It is reprinted at p. 1a of the Appendix to this Petition (hereinafter cited as "App.")

The judgment of the court below (App. 10a) affirmed an order of the United States District Court for the District of Columbia dismissing the case. That court's opinion is unreported. It is reprinted at App. 12a. The district court's order is reprinted at App. 21a.

B. Jurisdiction

The judgment below was dated July 27, 1990. Jurisdiction of this Court to review the case by writ of certiorari is conferred by 28 U.S.C § 1254(1).

C. Regulations Involved

The regulations involved, 17 C.F.R. §§ 240.14a-8 and 240.14a-9(a), are printed at App. 22a.

II. STATEMENT OF THE CASE

A. Basis for Federal Jurisdiction in the Court of First Instance

The court of first instance was the United States District Court for the District of Columbia. It had jurisdiction of the action under 28 U.S.C. § 1331, in that the action is a civil action arising under the laws of the United States, and under § 27 of the Securities Exchange Act of 1934, 15 U.S.C § 78aa, in that the action is based upon a violation of that Act and regulations of the SEC issued thereunder.

B. Facts Material to the Consideration of the Question Presented

Petitioner Grimes is a lawyer practicing in New York and as of the filing of the complaint below was a very substantial investor (300,000 common shares, worth some $4.8 million) in respondent Centerior, an Ohio electric utility holding company. Grimes timely advised management that he intended at the next meeting of the stockholders to offer an amendment to Centerior's articles of incorporation that would transfer the authority to make certain decisions as to capital expenditures from the board of directors acting alone, to the board and the stockholders jointly.[1] His proposal deals solely with this matter of internal corporate governance and the "constitutional" allocation of powers within the corporate structure;[2] it

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[1] Specifically, the proposal would amend the articles of incorporation of Centerior to add the following:

> "The Corporation (or in the aggregate any combination of the Corporation and/or its subsidiaries) shall not expend in any calendar year any monies by way of capital or construction expenditures in excess of the cash amount paid to the common shareholders as dividends in the preceding calendar year, without the formal prior consent of the common shareholders in each instance."

[2] As such it is squarely within the General Corporation Law of Ohio, which provides that the articles of incorporation of a corporation may set forth "[a]ny lawful provision for the purpose of defining, limiting, or regulating the exercise of the authority of . . . the directors, the officers, the shareholders, or the holders of any class of shares." OHIO REV. CODE ANN. § 1701.04 (Page 1988). In Ohio, as elsewhere, the charter (or articles of incorporation) of a corporation is a contract among the stockholders, *e.g.*, *Personal Industrial Bankers, Inc.* v. *Citizens Budget Co. of Dayton, Inc.*, 80 F.2d 327 (6th Cir. 1935), *cert. denied*, 298 U.S. 674 (1936), and it is not uncommon for charter provisions to

does not direct, forbid, or recommend any business operations, specific or general, at all.

SEC Rule 14a-8, 17 C.F.R. § 240.14a-8, commonly known as the stockholder proposal rules, provides that if a stockholder proposal and supporting statement are presented to management under prescribed conditions, management must include them in the proxy statement, and provide space on the proxy for stockholders to indicate their vote, unless the proposal falls within one or more of 13 specified excluded categories. That Grimes complied with the SEC's prescribed conditions is not in issue.

A company that has been properly notified by a stockholder that he wishes to present a proposal, but which contends that the proposal falls within one or more of the 13 excluded categories in the stockholder proposal rules, must make specified filings with the SEC setting forth why it believes that the proposal falls within one or more of the categories. SEC Rule 14a-8(d), 17 C.F.R. § 240.14a-8(d). Centerior made such filings in this instance. It contended that Grimes's proposal fell within three of the 13 excluded categories, *viz.*, proposals which would require the

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define the circumstances under which particular classes of stockholders shall have a vote with respect to corporate affairs—the commonest being, of course, a provision that preferred stock shall not vote, or shall be granted a vote only under defined circumstances, such as a default in declaring dividends. *E.g.*, *Krell* v. *Krell Piano Co.*, 23 Ohio App. 74 (1921). Grimes's proposal would simply give the common stockholders of Centerior a power to protect their interests comparable to that often enjoyed by preferred stockholders.

company to break the law,[3] proposals which deal with a matter relating to the ordinary business operations of the company,[4] and proposals which relate to specific amounts of cash or stock dividends.[5] The SEC staff issued a "no-action" letter, advising that there appeared "to be some basis for" omitting the proposal from the proxy materials on the ground that it would require the company to break the law, and that accordingly it would not recommend enforcement action to the Commission if the proposal were omitted. The staff did not address the other two exclusions claimed by Centerior. Grimes asked the Commission itself to review the staff's determination. Pursuant to its consistent practice, it declined to do so.[6]

Grimes accordingly filed the present action in the United States District Court for the District of Columbia, seeking an injunction against dissemination of proxy materials omitting Grimes's proposal. The in-

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[3] A proposal is exempted "if the proposal, if implemented, would require the [corporation] to violate any state law or Federal law of the United States . . . ." SEC Rule 14a-8(c)(2), 17 C.F.R. § 240.14a-8(c)(2).

[4] A proposal is exempted "if the proposal deals with a matter relating to the conduct of the ordinary business operations of the [corporation]." SEC Rule 14a-8(c)(7), 17 C.F.R. § 240.14a-8(c)(7).

[5] A proposal is exempted "if the proposal relates to specific amounts of cash or stock dividends." SEC Rule 14a-8(c)(13), 17 C.F.R. § 240.14a-8(c)(13).

[6] The SEC always leaves stockholder proposal matters to be handled at the staff level. This is to prevent direct judicial review by the court of appeals. See *Kixmiller* v. *SEC*, 492 F.2d 641 (D.C. Cir 1974), and *Medical Committee for Human Rights* v. *SEC*, 432 F.2d 659 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972).

junction was sought on two grounds. The first ground was that the proposal fell within none of the three excluded categories urged by Centerior and that hence the proxy statement must include the proposal and supporting statement and the proxy must afford an opportunity to direct a vote on the proposal, all under the specific requirements of Rule 14a-8. The second ground was more general. SEC Rule 14a-9(a), 17 C.F.R. § 240.14a-9(a), forbids the use of proxy materials which omit to state "any material fact necessary in order to make the statements therein not false or misleading." Grimes contended in his second count that even if his proposal fell within one of the exclusions from the stockholder proposal rules, so that management need not print it with a supporting statement in the proxy statement and supply a proxy ballot for voting on it, management was obliged under this rule against misleading proxies at least to apprise the stockholders of the fact, known to management, that Grimes would bring before the meeting this proposed major amendment to the articles of incorporation.

The district court dismissed the action. It rejected Centerior's contention that Grimes's proposal would force the company to break the law (thus reversing the SEC staff as to the only issue it had addressed), App. 19a, but held that, within the meaning of the stockholder proposal rules, the proposal dealt with a matter relating to the ordinary business operations of the company, *ibid.*, and also related to specific amounts of cash or stock dividends, App. 20a; so that it fell within both these exclusions. The district court failed to address Grimes's second contention at all, and thus held against him on it *sub silentio*.

The court of appeals affirmed, holding, on different grounds from the district court, that the proposal fell within the "ordinary business" exemption,[7] and expressing no opinion as to the exemption for proposals dealing with specific amounts of dividends. The court pointed out that under the SEC's own explanation of the "ordinary business" exemption, "only those proposals involving 'business matters that are mundane in nature and do not involve any substantial policy' considerations may be omitted" from proxy materials under that exemption. App. 6a, 909 F.2d at 531-32. It then said:

> "[T]he proposal is not limited in reach to those capital expenditure decisions involving substantial policy considerations or very large sums, but potentially extends to capital expenditures of any kind. For example, if in a given year no dividends were paid, all capital expenditure decisions for the following year, no matter how small, would have to be made by the shareholders. In such circumstances, Grimes's proposal would involve them in such minor or routine day-to-day decisions as the purchase of typewriters or the replacement of worn-out machinery. Such decisions would clearly be matters of ordinary business op-

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[7] The district court (overlooking the fact that Grimes's proposal dealt only with corporate powers and not with their exercise) had reasoned that because Ohio law imposes an obligation to make those capital expenditures that are necessary to ensure adequate service to its customers, decisions concerning such expenditures might be matters of "ordinary business." The court below observed that the district court's "conclusion does not necessarily follow from the fact that Centerior regularly must make capital expenditures to fill its public service obligations . . . ." App. 7a, 909 F.2d at 532.

eration. Centerior thus properly determined that Grimes's proposal fell within [the 'ordinary business' exemption]."

App. 7a-8a, 909 F.2d at 532-33.[8]

III. THE WRIT SHOULD BE ALLOWED BECAUSE THE QUESTION PRESENTED IS AN IMPORTANT ONE WHICH HAS NOT BEEN, BUT SHOULD BE, DECIDED BY THIS COURT.

A. The Court Below's Interpretation of the SEC's Stockholder Proposal Rules Undercuts Those Rules By Effectively Precluding Most Proposals for Reform of Corporate Governance From Being Brought Before the Stockholders.

The court below's reasoning as to the "ordinary business" exemption is a *non sequitur*. That exemption is self-evidently meant to keep stockholders from harassing their fellows (and management) with idiosyncratic ideas as to how minor, mundane day-to-day matters should be handled—as is amply confirmed by the SEC's own interpretation quoted by the court below, App. 5a-6a. By its own terms the exemption deals with *operations*—the *exercise* of power—and has nothing to do with *corporate governance*—the *alloca-*

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[8] On Grimes's second count, the court below held that a proposal falling within one of the exclusions from the stockholder proposal rules need not even be mentioned in the proxy statement. Its reasoning was apparently that, however significant the proposal might be and notwithstanding management's knowledge that it would be brought up from the floor at the meeting, the stockholders need only be apprised of proposals which are "proper" subjects for stockholder action, and that the 13 enumerated exemptions to the SEC's stockholder proposal rules define what is and is not a "proper" subject for stockholder action. App. 9a, 909 F.2d at 533.

tion of power. (Grimes's proposal, of course, deals with corporate governance and not with operations.)

Even under the court's own interpretation of the exemption, the logical inquiry was whether Grimes's proposal involved "substantial policy considerations." (Obviously it did: what policy question could be more substantial than the redistribution of power among the organs of the corporation?) But the court below made no such inquiry. Rather, it inquired whether, *if* authority were conferred on an organ of the corporation by the adoption of Grimes's proposal, there might *subsequently* be any hypothetical circumstances under which that organ might take action in an "ordinary business" matter. This inquiry—for lack of a better term, we will call it the "any subsequent action" test—is simply irrelevant.

From this illogical "any subsequent action" test flow the broad implications of the decision below that warrant grant of the writ. *For under this test, management could exclude from proxy materials almost every stockholder proposal for the reform of corporate governance.* Does a stockholder want to propose cumulative voting for the board of directors? Management could exclude that from the proxy materials, for the cumulatively-elected board might have to vote on an ordinary business operation. Does a stockholder want to propose that management salaries be set by a committee of outside directors? Management could exclude that from the proxy materials, on the ground that setting salaries is an ordinary business activity. Does a stockholder want to propose that the preferred stockholders be authorized to elect the board if three successive dividends are passed? Management could exclude that from the proxy materials, on the ground

that the board so elected might pass on an ordinary business matter. Indeed, it is not easy to devise a proposal for reform of corporate governance that *would* pass muster under the "any subsequent action" test of the court below.

B. The Question Presented Is Appropriate for Consideration by This Court at This Time.

The stockholder proposal rules—which this Court has never examined in depth—are the cornerstone of stockholder democracy, affected, as the court below long ago said in another case, with an "overriding" public interest "in assuring shareholders the right to control the important decisions which affect corporations." *Medical Committee for Human Rights* v. *SEC*, 432 F.2d 659, 680-81 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972). Corporate governance is a subject of intense current interest (having, for example, been the subject of close and controversial scrutiny by the American Law Institute for much of the past decade); in the age of hostile takeovers, poison pills, golden parachutes, and all the rest, no "decisions which affect corporations" are more important than those dealing with corporate governance; yet the reasoning of the court below would substantially foreclose consideration of stockholder proposals on that subject.

For the decision below to remain on the books is doubly pernicious because few cases under the stockholder proposal rules reach the courts of appeals; obviously this is because the SEC forces proposers to resort to the district courts in the first instance, see footnote 6 *supra*, and most proposers will abandon their efforts if they fail to secure preliminary relief against distribution of the proxy materials. The issue

is thus not one as to which prudence suggests that this Court await the ripening of a developed jurisprudence at the court of appeals level. We respectfully submit that this Court's consideration of this question now is timely and much needed.[9]

We also respectfully suggest that the views of the United States be sought, since the SEC was not a party to the litigation and the decision below goes to the heart of its enforcement of stockholder democracy.

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[9] As noted *supra* note 8, in ruling that management could refuse even to mention to the stockholders in the proxy statement that Grimes's proposal would be made at the meeting, the court's reasoning was apparently that the stockholders need only be apprised of proposals which are "proper" subjects for stockholder action, and that the 13 enumerated exemptions to the SEC's stockholder proposal rules define what is and is not a "proper" subject for stockholder action. We confess that we do not follow this reasoning. Even on its own terms, not only does it overlook the fact that the very first of the 13 enumerated exemptions is for proposals which are "not a proper subject for action by security holders" under "applicable state law," SEC Rule 14a-8(c)(1), 17 C.F.R. § 240.14a-8(c)(1) (it has never been suggested that this exclusion was here applicable, or that Grimes's proposal was not a proper subject for action by the stockholders, see note 2 *supra*); but also it ignores the fact that only a few weeks previously the very same court (almost the very same panel) had firmly rejected the notion that the SEC has any authority to define the proper subjects of stockholder action, or, as the court put it, to "step beyond control of voting procedure and into the distribution of voting power . . . ." *Business Roundtable* v. *SEC*, 905 F.2d 406, 410 (D.C. Cir. 1990). While the implications of this issue are not of the same magnitude as those of the primary issue, it presents a question of great practical significance in the administration of the stockholder proposal rules which should be settled by this Court.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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October 22, 1990

APPENDIX

APPENDIX A

Opinion of the Court Below

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued March 9, 1990 Decided July 27, 1990

No. 89-7053

C.L. GRIMES, APPELLANT

v.

CENTERIOR ENERGY CORPORATION

Appeal from the United States District Court
for the District of Columbia

(D.C. Civil No. 89-00386)

Thaddeus Holt for appellant.

Scott T. Kragie, with whom *Donald T. Bucklin* was on the brief, for appellee.

Before BUCKLEY, WILLIAMS, and D.H. GINSBURG, *Circuit Judges*.

Opinion for the court filed by *Circuit Judge* BUCKLEY.

BUCKLEY, *Circuit Judge*: Mr. C.L. Grimes, a shareholder of the Centerior Energy Corporation, seeks to compel Cen-

terior to include a proposed amendment to its articles of incorporation in its proxy materials, claiming that it is required to do so by Securities and Exchange Commission Rule 14a-8. Grimes appeals the district court's dismissal of his complaint. We find that the district court correctly determined that Grimes's proposal dealt with a matter relating to the conduct of Centerior's ordinary business operations and thus could be omitted from the proxy materials under an exemption to Rule 14a-8. We also hold that the failure of the proxy materials to apprise shareholders that Grimes would offer his proposal at the forthcoming shareholders' meeting did not render them misleading in violation of Rule 14a-9.

I. Background

Centerior is an Ohio corporation whose shares are traded on a national securities exchange. It owns two Ohio public utilities, The Cleveland Electric Illuminating Company and The Toledo Edison Company, which generate, transmit, and distribute electric power in northern Ohio and are regulated by the Public Utilities Commission of Ohio. At the time he initiated this suit, Grimes owned 300,000 shares of Centerior's common stock, worth approximately $4.8 million. Centerior's articles of incorporation and by-laws vest sole authority to make capital expenditures in its board of directors.

In October 1988, Grimes sent Centerior a proposed amendment to its articles of incorporation and a supporting statement, requesting that they be included in the proxy materials distributed for action at the next shareholders' meeting. The proposed amendment provides as follows:

> The Corporation (or in the aggregate any combination of the Corporation and/or its subsidiaries) shall not expend in any calendar year any monies by way of capital or construction expenditures in excess of the cash amount paid to the common shareholders as dividends in the preceeding [sic] calendar year,

> without the formal prior consent of the common shareholders in each instance.

Letter from C.L. Grimes to Richard Miller (Oct. 5, 1988).

Rule 14a-8 of the Securities and Exchange Commission requires Centerior to include in its proxy statement any proposal submitted for action by a shareholder unless it falls within one of thirteen exemptions, three of which are invoked by Centerior. *See* 17 C.F.R. § 240.14a-8 (1989). The relevant parts of Rule 14a-8 read as follows:

> (c) The [corporation] may omit a proposal and any statement in support thereof from its proxy statement ... under any of the following circumstances:
>
> ....
>
> (2) If the proposal, if implemented, would require the [corporation] to violate any state law ....
>
> ....
>
> (7) If the proposal deals with a matter relating to the conduct of the ordinary business operations of the [corporation];
>
> ....
>
> (13) If the proposal relates to specific amounts of cash or stock dividends.

17 C.F.R. § 240.14a-8(c)(2), (7), (13) (hereinafter exemptions 2, 7, and 13, respectively). If the corporation determines that a shareholder proposal falls within one of the enumerated exemptions, it must file the proposal and its supporting statement with the SEC, together with a statement of the reasons why the proposal need not be included in the corporation's proxy materials. 17 C.F.R. § 240.14a-8(d).

Centerior determined that Grimes's proposal fell within exemptions 2, 7, and 13, and made the requisite filing with the Commission. The SEC staff issued a "no-action" letter advising Centerior that there appeared "to be some basis for" omitting Grimes's proposal from its proxy statement

under exemption 2 because the proposal might result in a violation of provisions of Ohio law regulating the expenditures and dividends of public utilities. *Centerior Energy Corp.*, SEC No-Action Letter (Jan. 10, 1989) (LEXIS, Fedsec library, Noact file). The staff thus advised that it would not "recommend any enforcement action to the [SEC] if the Company omit[ted] the proposal from its proxy materials," and did not address the other exemptions asserted by Centerior. *Id.* Grimes asked the Commission to review the staff's determination, but it declined to do so.

Grimes then brought suit against Centerior, offering alternative grounds for seeking an injunction against dissemination of any proxy materials that omitted his proposal. First, Grimes asserted that the omission of his proposal would violate Rule 14a-8. Second, he contended that a failure to inform the shareholders that he would offer a major amendment to Centerior's articles of incorporation at the shareholders' meeting would be inherently misleading in violation of SEC Rule 14a-9, 17 C.F.R. § 240.14a-9(a), which provides that proxy materials may not contain false or misleading statements or omissions with respect to any material fact. After a hearing on Grimes's motion for a preliminary injunction and Centerior's motion to dismiss, the district court found that the case presented no factual issues, denied the injunction, and dismissed the complaint. *C.L. Grimes v. Centerior Energy Corp.*, Civ. No. 89-0386, mem. op. (D.D.C. Mar. 2, 1989) ("Memorandum").

The court held that Grimes's proposal would not *require* Centerior to violate provisions of Ohio law, and thus was not exempt from inclusion under exemption 2. *Id.* at 7-9. The court went on to find, however, that Grimes's proposal was covered by exemptions 7 and 13. First, it reasoned that the proposed amendment related to the conduct of Centerior's ordinary business operations because Centerior might be required to make certain capital expenditures to ensure that its utilities met the public service obligations imposed on them by state law. *Id.* at

9-10. Second, the court concluded that the proposal related to a specific amount of dividends because if they were to avoid the need for shareholder approval, the directors would have to vote cash dividends in any given year in an amount at least equal to the proposed capital expenditures for the following year. *Id.* at 10. The court did not address Grimes's alternative claim under Rule 14a-9. Grimes brought this appeal.

II. Discussion

Grimes argues that his proposal did not deal with matters relating to the conduct of Centerior's ordinary business operations or to specific amounts of dividends and thus did not fall within either exemption 7 or 13. He contends further that even if his proposal falls within one of these exemptions, the failure to apprise shareholders of his intent to offer a major amendment at the next shareholders' meeting would render the proxy materials misleading in violation of Rule 14a-9, and that the district court erred by effectively ruling against him on this claim. Grimes thus urges us to direct the district court to order Centerior to schedule and hold a supplemental session of the 1989 shareholders' meeting and to distribute proxy materials containing his proposal. We conclude that Grimes's proposal was properly excluded from Centerior's proxy materials under exemption 7, and express no opinion as to the applicability of exemption 13. Finally, we hold that the failure to mention a properly excluded shareholder proposal in the proxy materials does not render them misleading in violation of Rule 14a-9.

A. Exemption 7

Whether Grimes's proposal falls within exemption 7 obviously depends on the meaning of the phrase "ordinary business operations." Unfortunately, the phrase has no precise definition. When the SEC adopted Rule 14a-8(c)(7) in its current form, it explained that

> the term "ordinary business operations" has been deemed on occasion to include certain matters which

> have significant policy, economic or other implications inherent in them. For instance, a proposal that a utility company not construct a proposed nuclear power plant has in the past been considered excludable under [the former version of this exemption]. In retrospect, however, it seems apparent that the economic and safety considerations attendant to nuclear power plants are of such magnitude that a determination whether to construct one is not an "ordinary" business matter. Accordingly, proposals of that nature, as well as others that have major implications, will in the future be considered beyond the realm of an issuer's ordinary business operations ....

Adoption of Amendments Relating to Proposals by Security Holders, 41 Fed. Reg. 52,994, 52,998 (1976). Thus, only those proposals involving "business matters that are mundane in nature and do not involve any substantial policy" considerations may be omitted under exemption 7. *Id.* This exemption is premised on the notion that "management cannot exercise its specialized talents effectively if corporate investors assert the power to dictate the minutiae of daily business decisions." *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659, 679 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972).

From its no-action letters, it is clear that the SEC staff typically regards proposals bearing on a company's capital expenditures as relating to ordinary business operations. *See, e.g., Florida Power & Light Co.*, SEC No-Action Letter (Jan. 18, 1983) (LEXIS, Fedsec library, Noact file) ("the determination of whether or not to ... reduce capital expenditures ... [is a] matter[ ] relating to the Company's ordinary business operations"); *Allis-Chalmers*, SEC No-Action Letter (Mar. 3, 1982) (LEXIS, Fedsec library, Noact file) (proposal to restrict capital investment to existing facilities relates to conduct of ordinary business operations); *Middle South Utilities, Inc.*, SEC No-Action Letter (Feb. 24, 1981) (LEXIS, Fedsec library, Noact file) (proposal to reduce capital expenditures relates to conduct of ordinary business operations); *General Public Utilities Corp.*, SEC No-Action Letter (Feb. 21, 1980) (LEXIS,

Fedsec library, Noact file) (proposal to halt current capital expenditures for new generating capacity for all but emergency situations relates to the conduct of ordinary business operations).

In some cases, however, the SEC staff has found a proposal relating to capital expenditures to be sufficiently important to remove it from the realm of "ordinary business operations." *See Detroit Edison Co.*, SEC No-Action Letter (Feb. 13, 1980) (LEXIS, Fedsec library, Noact file) (proposal requiring that any project whose capital expenditure would exceed half a billion dollars be subject to shareholder approval did not fall within exemption 7 because "a capital expenditure of five hundred million dollars has such major implications for the future of the Company that it transcends the realm of ordinary business operations"); *see also General Public Utilities Corp.*, SEC No-Action Letter (Mar. 11, 1980) (LEXIS, Fedsec library, Noact file) (proposal to focus new power plant construction on non-nuclear sources of energy not within exemption 7 because it involved "broad policy considerations beyond the Company's ordinary business").

In determining that Grimes's proposal related to the conduct of Centerior's ordinary business operations, the district court recognized that large capital expenditures might fall outside of "ordinary business operations." Memorandum at 9. The court reasoned, however, that because Ohio law imposes an obligation to make those capital expenditures that are necessary to ensure adequate service to its customers, decisions concerning such expenditures might be matters of "ordinary business." *Id.* at 10. Although the court's conclusion does not necessarily follow from the fact that Centerior regularly must make capital expenditures to fulfill its public service obligations, it is clear that it arrived at the proper result.

Under Grimes's proposal, whether shareholder approval is required for the current year's capital expenditures depends on the level of the previous year's dividends. Thus, the proposal is not limited in reach to those capital

expenditure decisions involving substantial policy considerations or very large sums, but potentially extends to capital expenditures of any kind. For example, if in a given year no dividends were paid, all capital expenditure decisions for the following year, no matter how small, would have to be made by the shareholders. In such circumstances, Grimes's proposal would involve them in such minor or routine day-to-day decisions as the purchase of typewriters or the replacement of worn-out machinery. Such decisions would clearly be matters of ordinary business operations. Centerior thus properly determined that Grimes's proposal fell within exemption 7.

B. Rule 14a-9

The district court did not address Grimes's claim that proxy materials omitting mention of the fact that he would offer a major proposal at the shareholders' meeting would be inherently misleading in violation of Rule 14a-9, thus ruling against him *sub silentio*. In support of his claim, Grimes relies on the following language from *New York City Employees' Retirement Sys. v. American Brands, Inc.*, 634 F. Supp. 1382 (S.D.N.Y. 1986):

> Since a shareholder may present a proposal at the annual meeting regardless of whether the proposal is included in a proxy solicitation, the corporate circulation of proxy materials which fail to make reference to a shareholder's intention to present a *proper* proposal at the annual meeting renders the solicitation inherently misleading.

Id. at 1386 (emphasis added) (reasoning, from cases holding that Rule 14a-9 provides a private right of action, that such a right also exists under Rule 14a-8). *American Brands* actually stands for a somewhat different proposition than the one for which it is cited. It holds that the omission of a proposal *not* properly excludable under Rule 14a-8(c) will necessarily be misleading under Rule 14a-9, whereas the issue presented in this case is whether a proposal *properly* excluded under Rule 14a-8 must neverthe-

less be mentioned to avoid misleading shareholders under Rule 14a-9. Moreover, we can find no authority that does speak to this issue.

We note, however, that the regulations were originally designed to limit proposals to those that were proper subjects for shareholder action under applicable state law. *See Medical Comm. for Human Rights*, 432 F.2d at 677-78. The subsequent development of enumerated exemptions in Rule 14a-8(c) serves to define the "proper subjects" for such action. Therefore, if a proposal falls outside the range of "proper subjects," as implicitly defined by Rule 14a-8(c), neither the proposal itself nor the fact that its sponsor intends to present the proposal at the next shareholders' meeting need be included in the proxy materials. The interpretation urged by Grimes would clearly subvert the purpose of the exemptions to Rule 14a-8.

III. Conclusion

Grimes's proposal fell within exemption 7 of Rule 14a-8 and was therefore properly excluded from Centerior's proxy materials. Moreover, the failure to mention a proposal properly excluded under Rule 14a-8(c) does not render a proxy statement misleading under Rule 14a-9. The district court's order denying the injunction and dismissing Grimes's complaint is therefore

Affirmed.

APPENDIX B

The Judgment Sought To Be Reviewed

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1989

No. 89-7053

D.C. Civil No. 89-0386

C. L. Grimes,

Appellant

v.

Centerior Energy Corporation

United States Court of Appeals
For the District of Columbia Circuit

FILED JUL 27 1990

CONSTANCE L. DUPRÉ
CLERK

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Before: **BUCKLEY, WILLIAMS** and **D.H. GINSBURG,** Circuit Judges

JUDGMENT

This cause came on to be heard on the record on appeal from the United States District Court for the District of

Columbia and was argued by counsel. On consideration thereof, it is

ORDERED and **ADJUDGED**, by the Court, that the judgment of the District Court appealed from in this cause is hereby affirmed, in accordance with the Opinion of the Court filed herein this date.

Per Curiam
FOR THE COURT:

/s/ Constance L. Dupré
CONSTANCE L. DUPRE, CLERK

APPENDIX C

Opinion of the District Court

(Minor Typographical Errors Corrected)

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 89-0386 JGP

C. L. GRIMES,

Plaintiff

v.

CENTERIOR ENERGY CORPORATION,

Defendant

FILED

MAR 2 1989

CLERK, U.S. DISTRICT COURT
DISTRICT OF COLUMBIA

MEMORANDUM

In this action, the plaintiff, an individual stockholder in the defendant corporation, "seeks to require defendant to comply with the law and the rules of the Securities and Exchange Commission [SEC] by including, in a forthcoming proxy statement with respect to the defendant's annual meeting, information with respect to an amendment to the defendant's articles of incorporation proposed by plaintiff." Complaint par. 1. Plaintiff contends that this court has jurisdiction over this proceeding pursuant to §27 of the Securities Exchange Act of 1934, 15 U.S.C. §78aa, "in that it is based upon a violation of the Act and rules aforesaid, and more particularly upon violations of §14(a) of the said Act, 15 U.S.C. §§78n, and SEC Rule 14a-8 and 14a-9, 17 C.F.R. §§240.14a-8 and 240.14a-9." Complaint par. 2.

The case is now before the Court on plaintiff's motion for a preliminary injunction and defendant's motion to dismiss, or in the alternative, to transfer to the United States District Court for the Northern District of Ohio. With respect to the plaintiff's motion, the parties have agreed that the hearing on the motion for a preliminary injunction may be consolidated with a trial on the merits. *See* Fed. R. Civ. P. 65(a)(2). The parties also agree that there are no factual issues. The Court heard the motion on February 27, 1989.

After giving careful consideration to the motions, the Court concludes that plaintiff's motion for a preliminary injunction should be denied and that this case should be dismissed.

The subject proxy materials are to be mailed to the stockholders on or about March 13, 1989, and the annual stockholders' meeting will be held on April 25, 1989. In view of those time constraints, the Court will briefly set forth the underlying facts and the basis for its ruling.

I

The material facts are as follows: The plaintiff is a holder of 300,000 shares of common stock in the defendant having a market value in excess of 4.8 million dollars as the close of business February 10, 1989. Complaint par. 4. Defendant is a holding company whose subsidiaries are engaged in the generation, transmission and distribution of electric power. It is organized and existing under the laws of the state of Ohio and is subject to the securities laws of the United States and to regulation by, and the rules of, the Securities and Exchange Commission (SEC). The defendant is a "registrant" within the meaning of 17 C.F.R. §240.14a-8[1], and the issuance and distribution of

[1] "The term 'registrant' means the issuer of the securities in respect of which proxies are to solicited." 17 C.F.R. 240.a-1(h)

the proxy materials involved in this action are subject to those laws, regulations and rules. Complaint par. 5.

Under defendant's articles of incorporation and by-laws, the authority to make capital expenditures is vested solely in the board of directors (and in the executive committee thereof under certain circumstances). Complaint par. 6.

By letter dated October 5, 1988, plaintiff sent to defendant a proposed amendment to defendant's articles of incorporation pursuant to which such expenditures in excess of a defined amount would require the approval of stockholders, and requested that the proposal and a statement in support thereof be included in the proxy materials for the next regular or special meeting of the stockholders of the corporation. Complaint par. 7 and Exhibit 1 thereto. The proposed amendment provided:

> The Corporation (or in the aggregate any combination of the Corporation and/or its subsidiaries) shall not expend in any calendar year any monies by way of capital or construction expenditures in excess of the cash amount paid to the common shareholders as dividends in the preceding calendar year, without the formal prior consent of the common shareholders in each instance.

Complaint Exhibit 1. By letter dated December 1, 1988, to the Office of Chief Counsel, Division of Corporate Finance of the SEC, situated in this district, with a copy to plaintiff, defendant advised the SEC and plaintiff of its intention to omit plaintiff's proposal from its proxy statement relating to the annual stockholders' meeting scheduled to be held on April 25, 1989. Complaint par. 12. In that letter the defendant stated its intention to deliver preliminary proxy materials to the SEC on or before February 2, 1989, and to mail the proxy materials to the stockholders on or about March 13, 1989. *Id.* The defendant attached to its letter a "Statement of Intent to

Omit Shareholder Proposal" (Statement) in which it outlined the reasons for its decision to omit the plaintiff's proposal from the proxy material. Complaint Exhibit 3.

In its Statement, the defendant noted three reasons in support of its decision. First, the defendant contended that the proposed amendment would require the defendant's subsidiaries to violate the state law of Ohio. *See* 17 C.F.R. §240.14a-8(c)(2). Second, the defendant contended that the proposed amendment deals with a matter relating to the conduct of ordinary business of the defendant and its subsidiaries. *See* 17 C.F.R. §240.14a-8(c)(7). Finally, the defendant contended that the proposed amendment relates to specific amounts of cash or stock dividends. *See* 17 C.F.R. §240.14a-8(c)(13). On the same date, defendant submitted the legal opinion of its Assistant General Counsel to the SEC. Complaint par. 13 and Exhibit 4 thereto.

In a letter dated January 10, 1989, the SEC responded to defendant, with a copy to plaintiff. Complaint Exhibit 5. Enclosed with the letter was a "Response of the Office of Chief Counsel Division of Corporation Finance" (Response). Complaint Exhibit 6. The Response provides in part:

> The proposal relates to the amount of capital expenditures that can be made in relation to the amount of dividends that are declared.
>
> There appears to be some basis for your opinion that to the extent that the proposal links the amount of capital expenditures to dividend payments it may be omitted pursuant to Rule 14a-8(c)(2) since it *may* result in a violation of the Ohio Revised Code ("ORC") provisions regulating the activities of the Company. In arriving at our position, the staff has particularly noted that ORC section 4905.22 requires the Company to make such expenditures as are necessary to "furnish necessary and adequate (public utility) service and

> facilities" and that ORC section 1701.33 provides that the Company may pay dividends only out of its surplus.

Id. (emphasis the Court's).

By a letter dated January 25, 1989, the plaintiff requested the full SEC to review the above determination by the staff. Complaint par. 16 and Exhibit 8 thereto. The SEC declined to do so. Plaintiff's Exhibit 1[2].

II

In view of the time constraints, the Court will address only those issues which are pertinent to its decision in this case.

Defendant seeks to have the Court dismiss the case for lack of jurisdiction or lack of waiver, or in the alternative to transfer the case to the United States District Court for the Northern District of Ohio. Although time does not permit a extensive examination of the question of jurisdiction, the Court concludes that it does have jurisdiction over this matter and that venue is proper. *See, Hodgdon v. Needham-Skyles Oil Co.*, 556 F.Supp 75 (D.D.C. 1982). *See also, Hirt v. UM Leasing Corp.*, 614 F.Supp. 1066, 1069 (D.Neb. 1985). Moreover, in view of the short time before the mailing of the proxy statements, the Court will not transfer this action.

As was noted above, although this comes before the Court on the plaintiff's motion for a preliminary injunction and the defendant's motion to dismiss or transfer, the parties have agreed that the plaintiff's motion may be consolidated with a hearing on the merits. Since there is not a factual dispute, the Court may address the case without the need for testimony or other evidence.

---

[2] Plaintiff's Exhibit 1 was filed in Court at the time of the hearing.

Normally, when a stockholder of the registrant seeks to present a proposal, or in this case, a proposed amendment of the articles of incorporation or by-laws, the registrant is required to set forth the proposal in its proxy statement to the other stockholders, provided that the proponent has met all requirements. 17 C.F.R. §240.14a-8. The Court assumes, based upon the present record and the arguments of counsel, that the plaintiff has satisfied the necessary requirements and that the proposed amendment was properly before the registrant. The rules provided that a registrant may omit a proposal and any statement in support thereof under several circumstances, three of which are raised in this case. 17 C.F.R. §240-14a-8(c).

First, defendant contends that the proposal need not be included in the proxy statement because it would require the registrant to violate the Ohio law. The Division of Corporate Finance, SEC, advised that it would not recommend any enforcement action requiring defendant to include the proposal amendment in the proxy statement because it concluded that the proposal amendment, if adopted, *may* result in a violation of state law. The rules provide, in part, that the proposal need not be included: "If the proposal, if implemented, *would* require the registrant to violate any state law." 17 C.F.R. §240.14a-8(c)(2) (emphasis the Court's). Defendant argues that management cannot satisfy their statutory obligations under Ohio law unless management retains the freedom to set and adjust the level of capital expenditures.

There is no question but that this argument has some merit. Defendant's subsidiaries are electric power companies which are regulated by the state. It could be that under the law, the company would be required to make certain capital expenditures in a given year that are in excess of the amount of the case dividends paid during the previous year. That would raise a need for stockholder action which would in turn raise other questions concerning the timeliness of any action by the stockholders. In

this connection, defendant noted in its Statement that the amount of capital expenditures for the years 1985, 1986 and 1987 far exceeded the amount of cash dividends paid to the stockholders in the preceding years. For example, the company paid out cash dividends in 1984 in the amount of 245 million dollars while in the following year it expended 984 million dollars for construction. In 1984 it paid out cash dividends in the amount of 268 million dollars but spent over one billion dollars for capital expenditures.

There seems to be little doubt that the plaintiff's proposed amendment is directed at this imbalance. In his letter proposing the amendment he complains about dividends "hav[ing] been cut drastically". Complaint Exhibit 1. He notes that:

> There can be no excuse for reducing our dividends and complaining about inadequate returns, **while pouring our money into new construction.** Neither management nor any Ohio regulator can complain that requiring us to approve a capital expenditure at the shareholder level is too expensive or cumbersome, because it is our money which will be spent seeking to obtain *our* approval.

Id. (bold supplied by the Court). He then states that if management cannot receive a fair return, perhaps the monies should be invested elsewhere. *Id.*

While it is clear why the plaintiff has made his proposal, he apparently seeks to have the defendant or its subsidiary companies cut back on the amount of capital expenditures, passage of the proposed amendment would not insure that result. If the amendment was passed, any request for capital expenditures in excess of the prior year's cash dividends would be submitted to the stockholders, but that does not mean that the stockholders would vote to violate the state law, or that the defendant company would ultimately violate the state law. Nevertheless, the potential

is present and that appears to be exactly what the plaintiff seeks. This much is made clear by his letter, Complaint Exhibit 1, and by the past history of the company in which the amount of capital expenditures have exceeded the previous year's cash dividends for the past three years up to 1987. The returns are not in for the capital expenditures for 1988.

The proposed amendment *may* make the company violate a state law, but the rule speaks in terms of *requiring* the registrant to violate the state law. Apparently SEC has read this case situation as falling within Section 240.14a-8(c)(2). Based upon the present record, this Court cannot conclude that the proposal will require the registrant to violate state law, notwithstanding that such a result may be intended by the plaintiff; accordingly, the Court concludes that Section 240.14a-8(c)(2) standing alone is not a sufficient reason for defendant to refuse to send the proposed amendment to the stockholders.

The second argument made by the defendant is that the proposed amendment may be omitted from the proxy statement because it relates to the conduct of the ordinary business operations of the company. 17 C.F.R. §240.14a-8(c)(7). Here again it is questionable whether the expenditure of huge sums of money falls within the term "conduct of ordinary business operations." That term usually refers to the day-to-day operations where the management must have freedom to operate and of course would not extend to broad policy matters. It would seem in this case, however, that the term might encompass a requirement under state law that management make certain capital expenditures in order to bring or keep the utility in compliance with state law. For example, the utility must furnish electricity, and if the product cannot be furnished without a capital expenditure, then the directors are required to make that expenditure. This appears to relate to the conduct of ordinary business.

Finally, the proposed amendment is not required if the proposal relates to specific amounts of cash or stock dividends. 17 C.F.R. §240.14a-8(c)(13). The proposal refers to specific amounts of cash in that it would establish a formula which may come into play depending upon the circumstances. For example, if the company projected capital expenditures for 1990 in an amount of 500 million dollars, then under the proposal, in order to insure funds to make those capital outlays, the directors would be required to pay cash dividends in 1988 in an amount equal to or greater than the proposed capital expenditure. Under these circumstances, the proposed amendment relates to specific amount of cash or stock dividends.

Under these circumstances, the Court concludes that the defendant is not required to include the proposal in the proxy statement. Having reached this result, it follows that plaintiff is not entitled to a preliminary injunction and this case must be dismissed.

An appropriate order has been entered.

March 2, 1989

/s/ John Garrett Penn
JOHN GARRETT PENN
United States District Judge

APPENDIX D

Order of the District Court Dismissing the Action

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 89-0386 JGP

C. L. GRIMES,

Plaintiff

v.

CENTERIOR ENERGY CORPORATION,

Defendant

FILED

FEB 28 1989

CLERK, U.S. DISTRICT COURT
DISTRICT OF COLUMBIA

ORDER

Pursuant to the Memorandum to be filed, it is hereby

ORDERED that plaintiff's motion for a preliminary injunction is denied, and it is further

ORDERED that this case is dismissed with prejudice.

/s/ John Garrett Penn
JOHN GARRETT PENN
United States District Judge

APPENDIX E

Regulations Involved

17 C.F.R.§ 240.14a-8

(SEC Rule 14a-8, the Stockholder Proposal Rules)

(a) If any security holder of a registrant notifies the registrant of his intention to present a proposal for action at a forthcoming meeting of the registrant's security holders, the registrant shall set forth the proposal in its proxy statement and identify it in its form of proxy and provide means by which security holders can make the specification required by Rule 14a-4(b) [17 CFR 240.14a-4(b)]. Notwithstanding the foregoing, the registrant shall not be required to include the proposal in its proxy statement or form of proxy unless the security holder (hereinafter, the "proponent") has complied with the requirements of this paragraph and paragraphs (b) and (c) of this section:

(1) *Eligibility.* At the time he submits the proposal, the proponent shall be a record or beneficial owner of at least 1% or $1000 in market value of securities entitled to be voted on the proposal at the meeting and have held such securities for at least one year, and he shall continue to own such securities through the date on which the meeting is held. If the registrant requests documentary support for a proponent's claim that he is the beneficial owner of at least 1% or $1000 in market value of such voting securities of the registrant or that he has been a beneficial owner of the securities for one or more years, the registrant shall make such request within 14 calendar days after receiving the security holder proposal and the proponent shall furnish appropriate documentation within 21 calendar days after receiving the request. Appropriate documentation of the proponent's claim of beneficial ownership shall include:

(i) A written statement by a record owner or an independent third party, accompanied by the proponent's writ-

ten statement that the proponent intends to continue ownership of such securities through the date on which the meeting is held; or

(ii) A copy of a Schedule 13D (§ 240.13d-101 of this chapter), Schedule 13G (§ 240.13d-102 of this chapter), Form 13F (§ 249.325 of this chapter), Form 3 (§ 249.103 of this chapter) and/or Form 4 (§ 249.104 of this chapter), or amendments thereto, filed with the Commission and furnished to the registrant by the proponent, provided that such filings indicate the proponent's beneficial ownership as of or prior to the date on which the relevant one year period commences, and are supported by

(A) A copy of all subsequent amendments reporting a change in ownership level,

(B) The proponent's affidavit, declaration, affirmation or other similar document provided for under applicable state law attesting that the proponent continued to be the beneficial owner of at least 1% or $1000 in market value of such voting securities of the registrant throughout the required one year period and as of the date of the affidavit, declaration, affirmation or other similar document provided for under applicable state law, and

(C) The proponent's written statement that the proponent intends to continue ownership of such securities through the date on which the meeting is held. In the event the registrant includes the proponent's proposal in its proxy soliciting material for the meeting and the proponent fails to comply with the requirement that he continuously hold such securities through the meeting date, the registrant shall not be required to include any proposals submitted by the proponent in its proxy material for any meeting held in the following two calendar years.

(2) *Notice and Attendance at the Meeting.* At the time he submits a proposal, a proponent shall provide the registrant in writing with his name, address, the number of

the registrant's voting securities that he holds of record or beneficially, the dates upon which he acquired such securities, and documentary support for a claim of beneficial ownership. A proposal may be presented at the meeting either by the proponent or his representative who is qualified under state law to present the proposal on the proponent's behalf at the meeting. In the event that the proponent or his representative fails, without good cause, to present the proposal for action at the meeting, the registrant shall not be required to include any proposals submitted by the proponent in its proxy soliciting material for any meeting held in the following two calendar years.

(3) *Timeliness.* The proponent shall submit his proposal sufficiently far in advance of the meeting so that it is received by the registrant within the following time periods:

(i) *Annual Meetings.* A proposal to be presented at an annual meeting shall be received at the registrant's principal executive offices not less than 120 calendar days in advance of the date of the registrant's proxy statement released to security holders in connection with the previous year's annual meeting of security holders except that if no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than 30 calendar days from the date contemplated at the time of the previous year's proxy statement, a proposal shall be received by the registrant a reasonable time before the solicitation is made.

(ii) *Other Meetings.* A proposal to be presented at any meeting other than an annual meeting specified in paragraph (a)(3)(i) of this section shall be received a reasonable time before the solicitation is made.

NOTE: In order to curtail controversy as to the date on which a proposal was received by the registrant, it is suggested that proponents submit their proposals by Certified Mail—Return Receipt Requested.

(4) *Number of Proposals.* The proponent may submit no more than one proposal and an accompanying supporting statement for inclusion in the registrant's proxy materials for a meeting of security holders. If the proponent submits more than one proposal, or if he fails to comply with the 500 word limit mentioned in paragraph (b)(1) of this section, he shall be provided the opportunity to reduce the items submitted by him to the limits required by this rule, within 14 calendar days of notification of such limitations by the registrant.

(b)(1) *Supporting Statement.* The registrant, at the request of the proponent, shall include in its proxy statement a statement of the proponent in support of the proposal, which statement shall not include the name and address of the proponent. A proposal and its supporting statement in the aggregate shall not exceed 500 words. The supporting statement shall be furnished to the registrant at the time that the proposal is furnished, and the registrant shall not be responsible for such statement and the proposal to which it relates.

(2) *Identification of Proponent.* The proxy statement shall also include either the name and address of the proponent and the number of shares of the voting security held by the proponent or a statement that such information will be furnished by the registrant to any person, orally or in writing as requested, promptly upon the receipt of any oral or written request therefor.

(c) The registrant may omit a proposal and any statement in support thereof from its proxy statement and form of proxy under any of the following circumstances:

(1) If the proposal is, under the laws of the registrant's domicile, not a proper subject for action by security holders.

NOTE: Whether a proposal is a proper subject for action by security holders will depend on the applicable state law.

Under certain states' laws, a proposal that mandates certain action by the registrant's board of directors may not be a proper subject matter for shareholder action, while a proposal recommending or requesting such action of the board may be proper under such state laws.

(2) If the proposal, if implemented, would require the registrant to violate any state law or Federal law of the United States, or any law of any foreign jurisdiction to which the registrant is subject, except that this provision shall not apply with respect to any foreign law compliance with which would be violative of any state law or Federal law of the United States.

(3) If the proposal or the supporting statement is contrary to any of the Commission's proxy rules and regulations, including Rule 14a-9 [§ 240.14a-9 of this chapter], which prohibits false or misleading statements in proxy soliciting materials;

(4) If the proposal relates to the redress of a personal claim or grievance against the registrant or any other person, or if it is designed to result in a benefit to the proponent or to further a personal interest, which benefit or interest is not shared with the other security holders at large;

(5) If the proposal relates to operations which account for less than 5 percent of the registrant's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the registrant's business;

(6) If the proposal deals with a matter beyond the registrant's power to effectuate;

(7) If the proposal deals with a matter relating to the conduct of the ordinary business operations of the registrant;

(8) If the proposal relates to an election to office;

(9) If the proposal is counter to a proposal to be submitted by the registrant at the meeting;

(10) If the proposal has been rendered moot;

(11) If the proposal is substantially duplicative of a proposal previously submitted to the registrant by another proponent, which proposal will be included in the registrant's proxy material for the meeting;

(12) If the proposal deals with substantially the same subject matter as a prior proposal submitted to security holders in the registrant's proxy statement and form of proxy relating to any annual or special meeting of security holders held within the preceding five calendar years, it may be omitted from the registrant's proxy materials relating to any meeting of security holders held within three calendar years after the latest such previous submission: Provided, That—

(i) If the proposal was submitted at only one meeting during such preceding period, it received less than three percent of the total number of votes cast in regard thereto; or

(ii) If the proposal was submitted at only two meetings during such preceding period, it received at the time of its second submission less than six percent of the total number of votes cast in regard thereto; or

(iii) If the prior proposal was submitted at three or more meetings during such preceding period, it received at the time of its latest submission less than 10 percent of the total number of votes cast in regard thereto; or

(13) If the proposal relates to specific amounts of cash or stock dividends.

(d) Whenever the registrant asserts, for any reason, that a proposal and any statement in support thereof received from a proponent may properly be omitted from its proxy statement and form of proxy, it shall file with the Com-

mission, not later than 80 calendar days prior to the date the definitive copies of the proxy statement and form of proxy are filed pursuant to Rule 14a-6 (§ 240.14a-6 of this chapter), or such shorter period prior to such date as the Commission or its staff may permit, six copies of the following items:

(1) The proposal;

(2) Any statement in support thereof as received from the proponent;

(3) A statement of the reasons why the registrant deems such omission to be proper in the particular case; and

(4) Where such reasons are based on matters of law, a supporting opinion of counsel. The registrant shall at the same time, if it has not already done so, notify the proponent of its intention to omit the proposal from its proxy statement and form of proxy and shall forward to him a copy of the statement of reasons why the registrant deems the omission of the proposal to be proper and a copy of such supporting opinion of counsel.

(e) If the registrant intends to include in the proxy statement a statement in opposition to a proposal received from a proponent, it shall, not later than 30 calendar days prior to the date the definitive copies of the proxy statement and form of proxy are filed pursuant to Rule 14a-6, or, in the event that the proposal must be revised to be includable, not later than five calendar days after receipt by the registrant of the revised proposal, promptly forward to the proponent a copy of the statement in opposition to the proposal. In the event the proponent believes that the statement in opposition contains materially false or misleading statements within the meaning of Rule 14a-9 and the proponent wishes to bring this matter to the attention of the Commission, the proponent promptly should provide the staff with a letter setting forth the reasons for this view and a copy of the statement in op-

position and at the same time promptly provide the registrant with a copy of his letter.

17 C.F.R. § 240.14a-9(a)

(SEC Rule 14a-9(a), the Rule Against Misleading Proxy Materials)

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

FILED
DEC 20 1990
JOSEPH F. SPANIOL, JR.
CLERK

(2)

No. 90-647

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

C.L. GRIMES,

Petitioner,

v.

CENTERIOR ENERGY CORPORATION,

Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

BRIEF IN OPPOSITION OF RESPONDENT CENTERIOR ENERGY CORPORATION

Of Counsel:

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December 20, 1990

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

QUESTION PRESENTED

Did the Court of Appeals, pursuant to the Securities and Exchange Commission exemption for proposals "relating to the conduct of the ordinary business operations," properly hold that Centerior could exclude from its proxy materials a shareholder proposal limiting capital expenditures, regardless of size, to the amount of dividends distributed in the prior year?

RULE 29.1 STATEMENT

Respondent Centerior Energy Corporation is a publicly held corporation which has neither a parent corporation nor any subsidiary which is not wholly-owned.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-647

C.L. GRIMES,

Petitioner,

v.

CENTERIOR ENERGY CORPORATION,

Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF IN OPPOSITION OF RESPONDENT CENTERIOR ENERGY CORPORATION

STATEMENT OF THE CASE

Respondent Centerior Energy Corporation ("Centerior") is an Ohio electric utility holding company. Centerior is a publicly held company whose 140 million shares of common stock outstanding are traded on the New York Stock Exchange. As of the date of the filing of the complaint in this action, Petitioner C.L. Grimes ("Grimes") owned less than one percent of the outstanding shares.

Centerior's Articles of Incorporation specifically vest authority to make capital expenditures in the Board of Directors. Grimes informed Centerior's Chairman that he wished to include in the corporation's proxy materials an amendment to the Articles providing that:

> The corporation . . . shall not expend in any calendar year *any* monies by way of capital or construction expenditures in excess of the cash amount paid to the common shareholders as dividends in the preceeding [sic] calendar year, without the formal prior consent of the common shareholders *in each instance.* (Emphasis added).

While the Securities and Exchange Commission ("SEC") shareholder proposal rules require a corporation to include most shareholder proposals in its proxy materials, SEC Rule 14a-8(c), 17 C.F.R. § 240.14a-8(c) sets forth 13 exemptions permitting omission of proposals. Centerior excluded Grimes's proposal because it met the criteria of three of the exemptions: 14a-8(c)(2), 17 C.F.R. § 240.14a-8(c)(2), excluding proposals requiring a company to violate state law; 14a-8(c)(7), 17 C.F.R. § 240.14a-8(c)(7), excluding proposals concerning the conduct of a corporation's ordinary business operations; and 14a-8(c)(13), 17 C.F.R. § 240.14a-8(c)(13), excluding proposals relating to specific amounts of cash or stock dividends.

The SEC's Division of Corporate Finance issued a "no-action" letter concluding that Grimes's proposal was properly excluded by Centerior. Complaint Exhibit 6. The SEC found that Grimes's proposal fell

under exemption 2, permitting Centerior to omit proposals which would cause the corporation to violate state law. Grimes's proposal forces Centerior to violate Ohio laws requiring the company to make expenditures to provide necessary and adequate public service and to pay dividends solely out of surplus. In light of this decision, the SEC did not consider the alternative grounds for exclusion advanced by Centerior. Grimes sought review by the entire Commission, but the SEC declined to overturn the Division's decision.

Grimes next filed suit in the District Court for the District of Columbia seeking an injunction barring Centerior's distribution of proxy materials which did not contain his proposal. Although the District Court noted that Grimes's proposal might require Centerior to violate Ohio law, the court held that Grimes's proposal was omissible under the two other exemptions Centerior raised. Pet. App. 17a-20a. The court held that Centerior correctly omitted the proposal because it related both to the conduct of Centerior's ordinary business (exemption 7) and to specific amounts of cash or stock dividends (exemption 13).

The Court of Appeals for the District of Columbia Circuit affirmed in a unanimous decision. Pet. App. 1a. The Court of Appeals held that Grimes's proposal, by potentially coercing Centerior into seeking stockholder approval of even the smallest capital expenditures, related to Centerior's ordinary business operations and would interfere with management's ability to make the very day-to-day decisions which the shareholders entrust to them. Pet. App. 5a-8a. Having sustained the applicability of exemption 7, the

court did not reach the alternative grounds for omission of Grimes's proposal.

REASONS FOR DENYING THE WRIT

INTRODUCTION

There is no reason for this Court to grant Grimes's petition for a writ of certiorari. Neither of the questions presented is sufficiently important to warrant Supreme Court review. Although he contends that this is a case involving important issues of "shareholder democracy," in truth this suit concerns the routine application of the SEC shareholder proposal rules. Grimes's argument is nothing more than a semantic exercise which has been universally rejected. Furthermore, the Court of Appeals correctly decided the case below based on ample precedent. This is not a case involving an unresolved area of law. The Court of Appeals reached a decision consistent with the SEC's determination that corporations may exclude proposals intruding upon management's ability to make routine capital expenditures.

Finally, this Court should not grant the writ because Grimes's proposal has been held properly excluded under not one but *three* different exemptions to the shareholder proposal rules.

ARGUMENT

1. The Writ Should Be Denied Because There Is No Important Question Presented Before The Court

Grimes frames his case as involving "[t]wo matters of fundamental importance - stockholder democracy and corporate governance." Pet. 1. However, this case merely involves the routine interpretation of an agen-

cy's rules and their application to a narrowly defined set of facts that is consistent with a long line of administrative decisions and the only case law on point. While corporate governance may be an important and "lively" issue, Grimes is seriously mistaken in his belief that *this* is the case which presents that issue for review.[1]

Grimes contends that his proposal relates to the allocation of power, i.e., corporate governance, because it seeks to transfer authority to make certain capital expenditures from the Board of Directors to the shareholders. Pet. 8-10. Following Grimes's argument, every proposal transferring a decision from management to the shareholders is important and thus eligible for Supreme Court consideration. However, the allocation of power is truly significant only if the power transferred is significant. While it would certainly be revolutionary to require shareholder approval of mundane capital expenditures in a large publicly held corporation as encompassed by Grimes's proposal, it is not a matter requiring Supreme Court review.

Grimes seemingly also urges that the Court grant the writ to consider whether proxy materials which fail to mention a properly excluded shareholder proposal are misleading. Footnotes 8 and 9 of the petition

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[1] Grimes, in a particularly frail argument, also urges this Court to grant certiorari because the Supreme Court has never previously considered the shareholder proposal rules and he believes it is unlikely that other shareholders will appeal the denial of the inclusion of their proposals in proxy materials to the Supreme Court level. That the Court has not yet considered an issue or that litigants face a long road to reach the Supreme Court are obvious facts but not appropriate grounds for granting certiorari.

address this issue which even Grimes admits is "not of the same magnitude as . . . the primary issue" but which he argues is of "great practical significance in the administration of the stockholder proposal rules." Pet. 11. However, that resolution of an issue is of "practical significance" to the administration of an agency's regulations is not a proper ground for granting certiorari. Not only is this not an issue of sufficient weight to warrant Supreme Court review, but how the SEC implements its own rules is an area in which the court should defer to the expertise of the agency. *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 566 (1980).

2. The Writ Should Be Denied Because the Court Below Correctly Decided the Issues Presented

This Court should not grant the writ of certiorari because the Court of Appeals fully considered and correctly decided the issues before it. Based on ample SEC precedent, the Court of Appeals properly determined that Centerior could omit Grimes's proposal because it related to Centerior's ordinary business operations. Similarly, the Court of Appeals held that Centerior need not include notice in its proxy materials of an omissible proposal in light of the purpose for which the SEC adopted the shareholder proposal rules and because Grimes's position was totally unsupported by law.

The Court of Appeals followed well established precedent that shareholder proposals concerning a company's capital expenditures are properly excluded under the ordinary business operations exemption. For example, in *General Public Utilities Corp.*, SEC No-Action Letter (Feb. 21, 1980) (Lexis, Fedsec library, Noact file), the SEC found that a shareholder pro-

posal requiring a public utility to incur "capital expenditures for new generating capacity [only in] emergency situations" was properly excluded because it involved "matters relating to the conduct of the ordinary business operations of the issuer (i.e., the levels of service and construction programs of the company)." *See also Florida Power & Light Co.*, SEC No-Action Letter (Jan. 18, 1983) (Lexis, Fedsec library, Noact file) (proposal that Board of Directors "minimize . . . dilution of the equity and earnings of the shareholders" excluded because the "determination of whether or not to . . . reduce capital expenditures" related to company's ordinary business operations); *Allis-Chalmers*, SEC No-Action Letter (March 3, 1982) (Lexis, Fedsec library, Noact file) (proposal restricting company's investment to existing facilities involved conduct of ordinary business operations). The SEC allows such proposals to be excluded because they dramatically interfere with management's ability to operate the company efficiently by using their expertise to make qualified business decisions which are beyond the experience of shareholders. *Western Capital Inv. Corp.*, SEC No-Action Letter (March 16, 1989) (Lexis, Fedsec library, Noact file) (quoting SEC Release No. 34-12999 (Nov. 22, 1976)).

The Court recognized that capital investments requiring very large sums might not relate to ordinary business operations, even in an industry as capital intensive as that of a public utility. However, Grimes's proposal covers *all* capital expenditures, great and small. As the Court observed, "Grimes's proposal would involve them [shareholders] in such minor or routine day-to-day decisions as the purchase of type-

writers or the replacement of worn-out machinery." Pet. App. 8a. These matters indisputably relate to ordinary business however defined.

The Court of Appeals also correctly decided that Centerior's failure to notify shareholders that Grimes would present a proposal at the shareholders meeting which the corporation had rightly excluded from its proxy materials is both consistent with the SEC's goal in regulating shareholder proposals and completely logical. The only authority Grimes could muster in support of his argument below, *New York City Employees' Retirement System v. American Brands, Inc.*, 634 F. Supp. 1382 (S.D.N.Y. 1986) was inapposite.[2] In contrast to the instant suit, *American Brands* concerned a proposal which was *not* excludable under any of SEC Rule 14a-8(c)'s exemptions. Without any precedent to support Grimes's argument, the court turned to the purposes underlying the shareholder proposal rules. The court concluded that "if a proposal falls outside the range of 'proper subjects,' [for shareholder action] as implicitly defined by Rule 14a-8(c), neither the proposal itself nor the fact that its sponsor intends to present the proposal at the next shareholders' meeting need be included in the proxy materials." Pet. App. 9a. Otherwise, no proposal could ever be excluded and the shareholder proposal rules would serve no purpose.

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[2] Curiously, since the Court of Appeals opinion stating that Grimes miscited the *American Brands* holding, Pet. App. 8a, he has not offered any authority in support of his claim that Centerior violated SEC Rule 14a-9(a), 17 C.F.R. § 240.14a-9(a).

3. The Writ Should Be Denied Because There Are Alternative Grounds on Which the Judgment Could Be Affirmed

Even if this Court were to determine that the Court of Appeals wrongly decided that Grimes's proposal fell within the exemption for conduct relating to ordinary business operations, the Court should be aware that at various stages of this litigation, Centerior's omission of Grimes's proposal was upheld under two independent exemptions. Although the Court of Appeals did not reach those issues, either ground would be sufficient to sustain the judgment in this case.

The SEC found that Grimes's proposal was excludable under exemption 2 which permits omission of proposals which "if implemented, would require the [corporation] to violate any state law." The SEC reasoned that adoption of Grimes's proposal would require Centerior to violate two provisions of Ohio law if the shareholders failed to authorize essential capital expenditures. Centerior is under a duty to provide "necessary and adequate service and facilities" to its customers, Ohio Rev. Code Ann. § 4905.22 (Baldwin 1990); an obligation which requires Centerior to incur expenses to meet the present and future demand for electricity. However, if the shareholders did not approve capital expenditures in excess of the amount of dividends distributed during the preceding year, Centerior would not be able to fulfill its statutory obligation to provide "necessary and adequate" service.

Centerior is also constrained by state law to distribute dividends solely from surplus. Ohio Rev. Code Ann. § 1701.33 (Baldwin 1990). The SEC found that

Grimes's proposal might force Centerior to violate this provision because if Centerior sought to avoid a potential shareholder veto of needed capital expenditures in the following year, it would have to declare unusually large dividends. However, if these dividends could not be distributed solely from surplus, Centerior would violate § 1701.33 of the Ohio Code.

In addition, the District Court approved Centerior's reliance upon exemption 13, which permits exclusion of shareholder proposals relating to "specific amounts of cash or stock dividends." The District Court held that Grimes's proposal refers to specific amounts of cash because it potentially creates a formula for the payment of dividends. Pet. App. 20a. To ensure that Centerior could make all necessary capital expenditures, the company would be forced to distribute to the shareholders dividends which were at least equal to the sum of expenditures Centerior anticipated incurring in the upcoming year. This decision is consistent with SEC decisions excluding similar proposals establishing a formula for the payment of dividends. *See, e.g., The Boeing Co.*, SEC No-Action Letter (Jan. 19, 1989) (Lexis, Fedsec library, Noact file) (proposal that company declare a 2 for 1 stock split created a formula); *Citicorp*, SEC No-Action Letter (Feb. 22, 1988) (Lexis, Fedsec library, Noact file) (proposal to increase dividends yearly by at least 10%).

CONCLUSION

For the reasons stated above, the writ of certiorari should be denied.

Respectfully submitted,

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No. 90-647

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

C.L. GRIMES,

Petitioner,

v.

CENTERIOR ENERGY CORPORATION,

Respondent.

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

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IN THE

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Respondent.

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

The question posed by the petition is the correctness of the "any subsequent action" rule adopted by the court below—the principle that management may exclude from proxy materials a proposed reform in corporate governance, however significant, if there are *any* circumstances, however unlikely, under which an ordinary business action might be taken under the proposed new governance.

Since respondent's brief (cited herein as "Resp. Br.") never addresses this question, there is little to say in reply.

We do note respondent's assertion that what is here involved is an "SEC[ ] determination," Resp. Br. at 4; its assertion that in this case "the SEC found"

certain matters, *id.* at 9[1]; its references to "SEC precedent", *id.* at 6; its statements that in other instances "the SEC found" or "the SEC allows" various items, *id.* at 8-9; and its reference to "SEC decisions," *id.* at 10. These formulations are highly misleading. Neither the administrative event in this case, nor any of the Lexis references which respondent's brief cites as if they were SEC actions, was in fact an action by the SEC. All were simply "no-action letters" advising that the SEC's employees would not recommend to the Commission that it institute enforcement proceedings under defined circumstances. The weight to which such staff letters are entitled is so modest that they have been held not to constitute reviewable agency action. *Kixmiller* v. *SEC*, 492 F.2d 641 (D.C. Cir. 1974).[2] As we pointed out in our Petition, the absence of SEC action in this field reflects the SEC's deliberate policy of circumventing direct judicial review, and this policy confers on the decision below an unusual "leverage" that makes peculiarly appropriate this Court's exercise of its supervisory authority.

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[1] Respondent's assertions that the SEC staff "found" certain matters in this case should be contrasted with the highly tentative actual text of the no-action letter here involved, Pet. App. at 15a-16a.

[2] *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980), cited at Resp. Br. 6, dealt with a radically different situation in which Congress had by express statutory language rendered "conformity with any interpretation or approval by an *official or employee* of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals" a defense against liability under the statute in question. 444 U.S. at 567 (emphasis added).

And in any event, none of the no-action letters cited by respondent deals with the "any subsequent action" test—which is the issue here.

We note also respondent's suggestion (Resp. Br. at 9-10) that the petition should be denied because respondent has advanced two grounds, in addition to those relied on by the court below, as to which it has contended that it should prevail. Neither of these asserted grounds was considered by the court below (as respondent recognizes, Resp. Br. at 9); furthermore, one of them had been rejected by the district court. Accordingly, even if there had been any merit in either of these asserted grounds (in petitioner's view there clearly was none), neither of them has any bearing on the grant of certiorari. Perhaps respondent's argument is a confusion of the familiar principle that this Court has no jurisdiction to disturb a judgment that rests on an adequate and independent state ground.

Respectfully submitted,

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Respondent.

MOTION OF UNITED SHAREHOLDERS ASSOCIATION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* AND BRIEF OF UNITED SHAREHOLDERS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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IN THE

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OCTOBER TERM, 1990

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C.L. GRIMES,

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CENTERIOR ENERGY CORPORATION,

Respondent.

MOTION OF UNITED SHAREHOLDERS ASSOCIATION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

United Shareholders Association ("USA") respectfully moves the Court for leave to file the attached brief as *amicus curiae* in support of the petition for certiorari in this case.

Written consent to filing of such a brief has been given by the petitioner and has been filed with the Clerk. The respondent, however, has refused consent—on the stated ground that doing so "would not be in the best interests" of the respondent. USA respectfully submits, however, that for its brief to be received would be in the best interests of justice and materially helpful to the Court.

As is set forth in more detail in the proposed brief under "Interest of the *Amicus Curiae*," USA is a nationwide grass-roots organization of 64,000 stockholders, with a record of successful action to protect and

enhance the rights of the American investor; with a particular interest in reform of corporate governance; and with a special interest in the SEC's rules enabling stockholders' proposals for reform to be included in proxy materials and brought before the shareholders for a vote.

From the perspective of its extensive and well-developed interests and experience in the field here involved, USA is in a position to bring to the Court's attention the degree to which the implications of the opinion below transcend the particular stockholder proposal under review, and threaten a broad undermining of the stockholder proposal rules; and is in a position also to discuss in depth the way in which the SEC's customary procedure in stockholder proposal cases confers upon the opinion below a special "leverage" that at first sight it might not appear to have.

USA thus believes that, in the words of Rule 37.1, its brief will "bring relevant matter to the attention of the Court that has not already been brought to its attention by the parties," and hence can be "of considerable help to the Court."

USA takes no position with respect to the particular stockholder proposal here involved.

Respectfully submitted,

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QUESTION PRESENTED

The *amicus curiae* adopts the statement of the question presented in the petition for certiorari.

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BRIEF OF UNITED SHAREHOLDERS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

United Shareholders Association ("USA"), as *amicus curiae*, respectfully urges that the petition for certiorari in this case be granted.

The interpretation which the opinion below in this case has placed on the SEC's stockholder proposal rules is a grave setback to the cause of shareholder democracy. USA respectfully submits that this Court's review and correction of that interpretation is essential. (USA takes no position as to the merits of the specific proposal here involved).

I. INTEREST OF THE *AMICUS CURIAE*

USA is a nonprofit grass-roots organization of individual stockholders, large and small, with 38 local

chapters and a headquarters in Washington, which in the four years since its foundation has grown to a membership of 64,000 individual stockholders in all 50 states. Organized in response to the growing perception that lack of management accountability has spawned an era of bloated, unresponsive corporations characterized by empire-building and bureaucracy, and currently chaired by a former Commissioner of the SEC, it is dedicated to protecting and enhancing the rights of the American investor. Its agenda includes, among other things, the elimination of management schemes such as "greenmail"[1] eliminating, or requiring shareholder votes on, such other abusive schemes as multi-million-dollar "golden parachute" deals[2] and "poison pill" arrangements;[3] and reform of the proxy

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[1] "Greenmail" is the purchase by management of the stock of one shareholder at a premium price and pursuant to an offer that is not available to the company's other shareholders. Greenmail payments eliminate a challenge to management and typically result in sharp reductions to a company's share value.

[2] "Golden parachutes" are severance contracts which guarantee to existing management that if they lose their jobs as a result of a change of corporate control, they will receive payment of a specified amount, usually several times their regular annual compensation.

[3] "Poison pill" plans involve the issuance of rights to buy stock at a discount, which are triggered by the acquisition of a threshold level of stock which has not received the approval of the incumbent board. By diluting the equity and voting rights of an acquiring shareholder, poison pills render uneconomic the acquisition of a controlling interest in a company without approval of the incumbent board. *See Concept Release on Takeovers and Contests for Corporate Control: Advance Notice of Possible Commission Actions*, Exchange Act Release No. 34-23486, [1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,018 (July 31, 1986); SEC Office of Chief Economist, *The Effects of Poison*

voting system to ensure fairness and greater opportunity for shareholder involvement. USA seeks to place stockholder proposals onto corporate proxy ballots, participates in SEC and court proceedings, lobbies in Congress and the states, and conducts educational activities. It publishes an annual "Shareholder 1000" rating of 1,000 of America's largest corporations by their responsiveness to shareholders, and creates an annual "Target 50" program targeting 50 of the country's worst offenders of shareholder rights for direct action in boardrooms and at annual shareholder meetings.

USA has been effective. As is discussed in further detail *infra*, management is generally hostile to stockholder proposals—especially to proposals for reform of corporate governance that might reduce their privileges and perquisites—and even if a stockholder proposal manages to get on the proxy, management usually sees that it is voted down. Nevertheless, in 1990 USA obtained majority votes in favor of shareholder rights proposals at six major companies; secured overall support for its proposals exceeding 35% at 35 targeted companies where votes were recorded; secured agreement by management at six companies to adopt confidential proxy voting in response to shareholder proposals; and secured consideration of proxy proposals on "golden parachutes" at eight companies.

The ability to have a proposal included in proxy materials under the SEC's stockholder proposal rules

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Pills on the Wealth of Target Shareholders (October 1986); SEC Office of Chief Economist, *The Economics of Poison Pills* (March 1986).

is the most potent single weapon in USA's efforts to secure corporate governance reforms of this kind. USA is thus vitally interested in anything that narrows or weakens these rules—as does the opinion of the court of appeals in this case.

II. SUMMARY OF ARGUMENT

The interpretation of the SEC's stockholder proposal rules enunciated by the court of appeals in this case is of broad applicability and will seriously impede the ability of stockholders to have proposals for reform of corporate governance included in proxy materials for stockholders' meetings. Although there is a great deal of stockholder proposal activity before the SEC's staff, because of special procedural peculiarities the stockholder proposal rules have only rarely come before the courts. This confers a disproportionate "leverage" upon the opinion below, emphasizing the appropriateness of this Court's guidance.

III. ARGUMENT

Two aspects of the decision of the court of appeals are particularly important to consideration of the petition for certiorari. One is the very broad and sweeping nature of the principle followed by the court of appeals—far transcending the significance of this particular case. The other is the great "leverage" of this one decision, because of procedural peculiarities which sharply limit the number of court of appeals interpretations of the stockholder proposal rules. Before discussing these, we will put them in context by describing in simplified form what happens under the SEC's stockholder rules when a stockholder offers a

proposal for inclusion in the proxy materials for an annual or special meeting of a corporation.[4]

A. The Stockholder Proposal Process

A qualified stockholder initiates his proposal by asking management to include it and a supporting statement in the proxy materials for the meeting. If management does not wish to do so, it files with the SEC staff a statement of why it contends the proposal falls within one of 13 excluded categories. If the staff disagrees, management usually does not pursue the matter further, and includes the material in the proxy materials, expecting that most proxies will support management against the proposal (see *infra*). If the staff agrees with management, it issues a "no-action" letter advising that it will not recommend that the Commission institute enforcement action against the company if it refuses to include the proposal.

If the staff does that, at this point the stockholder has no further administrative remedies. Appeal to the Commission will be fruitless, for the Commission will decline to construe and enforce its own rules. This singular practice reflects continuing Commission resistance, after more than twenty years, to the decision of the District of Columbia Circuit in *Medical Committee for Human Rights* v. *SEC*, 432 F.2d 359 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972), that a Commission ruling that a proposal need not be included in proxy materials was reviewable in the court of appeals under § 25(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78y. The Commission

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[4] The stockholder proposal rules are described in detail in the Petition, and set forth in full in its Appendix.

obtained a writ of certiorari in that case, but after oral argument it procured vacation of the writ on grounds of mootness. 404 U.S. 403. Subsequently, the District of Columbia Circuit held, in *Kixmiller* v. *SEC*, 492 F.2d 641 (D.C. Cir. 1972), that a staff no-action letter, as opposed to a ruling by the Commission itself, was not reviewable under the Securities Exchange Act. The Commission has accordingly left such matters to the staff ever since.

The stockholder's only recourse, therefore, is a district court action against the company—founded not on any statutory authority, but on the implied right of action derived from *J.I. Case Co.* v. *Borak*, 377 U.S. 426 (1964)—to enjoin dissemination of proxy materials that omit his proposal. Since time is usually short, this generally entails an application for temporary restraining order and preliminary injunction. With supporting papers and any necessary evidentiary hearing, this can be an expensive and somewhat complicated process, and not many of these actions have been brought. And even stockholders who have the resources to get this far will generally give up if they fail to secure preliminary relief at this point.[5]

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[5] The District of Columbia Circuit commented long ago on the undesirability of the practice the SEC has elected to follow, especially from the viewpoint of the small stockholder. "There is also, it seems to us, an independent public interest in having the controversy decided in its present posture [*i.e.*, by way of SEC decision followed by court of appeals review] rather than in the context of a private action against the company. The primary and explicit purpose of section 14(a) is 'the protection of investors,' and the primary means of reaching this goal is through Commission regulation of proxy statements, not through private actions by individual security holders. For the small investor, personal recourse to the Commission's proxy proce-

Now, though the stockholders own the company and in a real sense *are* the company, all too often present-day managements regard them much as medieval kings regarded their citizenry: ignorant and potentially turbulent folk who should stay quiet and let their betters run things. To such managements, stockholders' meetings are charades,[6] and stockholder proposals are irritations at best, if not outright *lèse-majesté*. Such managements are inclined to fight these battles to the last ditch, seizing upon any plausible argument why the proposal falls within one of the 13 exclusions. Moreover, even stockholder proposals that do manage to make it to the proxy materials stand little chance of adoption. In most companies, proxy voting is non-confidential: management knows how every stockholder votes. As a result, many stockholders fear to vote against management, whatever their views as to the merits of a proposal. "[E]mployees are loath to vote against their superiors. Investment analysts may not wish to offend management because it might affect their access to information. Fiduciaries, like banks, insurance companies

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dures without benefit of counsel may well be the only practicable method of contesting a management decision to exclude his proxy proposal. In this situation, . . . it is particularly important that the Commission look carefully at the merits of the shareholder's proposal, and that it do so pursuant to an accurate perception of the Congressional intent underlying the proxy statute. . . . Direct judicial review of Commission proxy decisions is unquestionably the most logical and efficient means of achieving this objective." *Medical Committee for Human Rights* v. *SEC*, 432 F.2d 659, 672 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972)(footnotes and citations omitted).

[6] One leading authority has called them "a kind of ancient meaningless ritual." *A.A. Berle, Economic Power and the Free Society* 7 (1957).

and pension fund managers, must consider their flow of business from corporations. . . ."[7] Bank trust officers in particular fear to jeopardize the bank's relations with the company, and worry that failure to support management may deter other companies from placing their pension funds with the bank.[8]

So though the stockholder proposal rules offer the only presently available path to real shareholder democracy, that path is a difficult and rocky one at best. The principle followed by the court of appeals in the present case makes it more so.

B. The Principle Followed by the Court of Appeals Broadly Undermines the Stockholder Proposal Rules

In the decision below the court of appeals recognized that in promulgating the current version of the "ordinary business" exception to the stockholder proposal rules, the SEC made it clear that "proposals . . . that have major implications . . . [are] considered beyond the realm of a [corporation's] ordinary business activities," so that "only those proposals involving 'business matters that are mundane in nature and do not involve any substantial policy' considerations

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[7] S. Rep. No. 100-265, 100th Cong. 1st Sess. 126n.90 (1987)(views of Senator D'Amato).

[8] See Curzan and Pelesh, *Revitalizing Corporate Democracy: Control of Investment Managers' Voting on Social Responsibility Proxy Issues*, 93 Harv. L. Rev. 670, 687 (1980); *Pozen, Financial Institutions: Cases, Materials and Problems on Investment Management* 13 (1978); *E. Herman, Conflicts of Interest* 28 (1975). Indeed, there exists a so-called "Wall Street Rule," which decrees that if an investment manager disapproves of the position of management he should either "swallow his qualms or sell the stock." Curzan and Pelesh, *supra*, at 686.

may be omitted under [the 'ordinary business'] exemption. . . ." Petition for Certiorari, Appendix ("Pet. App.") at 6a, quoting the SEC's statement at 41 Fed. Reg. 52,998 (1976). But, having enunciated this principle, the court did not inquire whether the proposal before it had "major implications." Rather, it inquired whether the proposal was "limited in reach" *solely* to major implications,[9] and held that if it was not—if it could have *any* minor implications under any hypothetical circumstances—then it fell within the "ordinary business" exclusion no matter how great its major implications might be.[10] As applied by the court in the present case, this produced what the Petition calls the "any subsequent action" test: management can exclude a stockholder proposal for a change in corporate governance from the proxy materials under the "ordinary business" exclusion if there are any circumstances under which an ordinary business action might be taken under the proposed new corporate governance. Petition for Certiorari at 9.

This test would enable hostile management to exclude many, if not indeed the great majority of, pro-

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[9] "[T]he proposal is not limited in reach to those capital expenditure decisions involving substantial policy considerations of very large sums, but potentially extends to capital expenditures of any kind." Pet. App. 7a-8a.

[10] "For example, if in a given year no dividends were paid, all capital expenditure decisions for the following year, no matter how small, would have to be made by the shareholders. In such circumstances, Grimes's proposal would involve them in such minor or routine day-to-day decisions as the purchase of typewriters or the replacement of worn-out machinery. Such decisions would clearly be matters of ordinary business operations." Pet. App. 8a.

posals for significant reform of corporate governance. For example, USA opposes "classified boards," under which directors are elected for staggered terms to forestall clean-sweep replacement of unsatisfactory management by the shareholders. But a proposal to abolish a classified board will evidently be caught by the "any subsequent action" test, since the ordinary business of any corporation is conducted by its board. Again, USA supports confidential proxy voting, to eliminate the abuses that flow from management's knowledge of how every stockholder votes; the extension of this reform is one of USA's "Target 50" goals for 1991. But under the "any subsequent action" test, any effort to put confidential voting on a corporate ballot is likely to be blocked on the ground that one result might be confidential voting on some ordinary business matter. These are but two examples, drawn from USA's current agenda, of many that might be offered.

But there is a wider ground for concern. The reasoning behind the "any subsequent action" test applied by the court of appeals is not only broader than its application to the particular proposal here involved; it extends potentially to other situations than a "subsequent action" and other exemptions besides that for "ordinary business." The court's basic reasoning is that a proposal must be "limited in reach" solely and exclusively to matters that fall totally outside the 13 exclusions, and that if under any set of hypothetical circumstances some connection can be made between the proposal and one of the 13 exclusions, then the proposal is exempt and can be omitted by management. On this logic, a proposal for confidential proxy voting could arguably be excludable un-

der the exemption for proposals that relate to an election to office.[11] On this logic, since one side effect of a "poison pill" plan will be to dilute the dividends of existing shares in proportion to the amount of new stock issued, a proposal requiring shareholder approval of such plans could be excludable under the exemption for proposals dealing with specific amounts of dividends.[12] Such an interpretation of the stockholder proposal rules is diametrically opposed to their remedial intent and spirit, and USA does not suggest that such interpretations would ultimately be adopted. But they illustrate the kind of obstacles to corporate reform which the reasoning of the court of appeals affords to any management resolved upon a last-ditch defense.

C. This Court Should Exercise Its Authority Because of the Special and Peculiar "Leverage" of the Decision Below

Though the stockholder proposal rules have been on the books in some form since 1942, USA has found only five other reported cases in which they have been addressed by the courts of appeal,[13]plus five more

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[11] A proposal is exempted "if the proposal relates to an election to office." SEC Rule 14a-8(c)(8), 17 C.F.R. § 240.14a-8(c)(8).

[12] A proposal is exempted "if the proposal relates to specific amounts of cash or stock dividends." SEC Rule 14a-8(c)(13), 17 C.F.R. § 240.14a-8(c)(13).

[13] *Rauchman* v. *Mobil Corp.*, 739 F.2d 205 (6th Cir. 1984); *Jansky* v. *Miller*, 474 F.2d 365 (9th Cir. 1973); *Kixmiller* v. *SEC*, 492 F.2d 641 (D.C. Cir. 1972); *Medical Committee for Human Rights* v. *SEC*, 432 F.2d 659 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972); and *Dyer* v. *SEC*, 290 F.2d 541 (8th Cir. 1961), 289 F.2d 242 (8th Cir. 1961), 266 F.2d 33 (8th Cir. 1959).

apparently unappealed reported district court cases;[14] none of which offers any significant substantive interpretation. USA recognizes that ordinarily this would militate against grant of certiorari, on the ground that the topic was of limited interest, or was one as to which the courts of appeals should be let alone to explore its implications before this Court steps in.

Here, however, appearances are deceiving. The paucity of court decisions under the stockholder proposal rules reflects only the exceptional procedural aspect of these cases, described at pp. 5-7 *supra*, under which the SEC leaves them to the staff and very few of them reach even the district courts, much less the courts of appeal. This does not mean the topic is not a lively one. For by contrast, entries for staff actions under those rules cover some eight pages in the relevant CCH volume, Fed. Sec. L. Rep. (CCH) ¶ 24,151.80 at 17,691-14 to 17,691-21, embracing perhaps 150 such actions; and Lexis reports a total of no less than 4,537 staff letters since 1971 which appear to deal with stockholder proposals.[15] Under these circumstances, the paucity of court decisions in this

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[14] *New York City Employees' Retirement System* v. *American Brands, Inc.*, 634 F.Supp. 1382 (S.D.N.Y. 1986); *Lovenheim* v. *Iroquois Brands, Ltd.*, 618 F.Supp. 554 (D.D.C. 1985); *Mougios* v. *W.R. Grace & Co.*, 52 F.R.D. 576 (S.D.N.Y. 1971); *Brooks* v. *Standard Oil Co. (New Jersey)* , 308 F.Supp. 810 (S.D.N.Y. 1969); *Peck* v. *Greyhound Corp.*, 97 F.Supp. 679 (S.D.N.Y. 1951).

[15] This is the number of items reported by Lexis in its NOACT file under GENFED and FEDSEC, searched for "14a-8" and "proposal" and "stockholder or shareholder." Because of their great number USA has not examined all these individually and accordingly cannot represent that all constitute rulings on individual stockholder proposals. But it is very evident in any case that the subject-matter is an extremely active one.

otherwise busy field actually makes this Court's intervention more appropriate rather than less, for it confers an extraordinary "leverage" on the decision below which it would not otherwise have.

Given the extraordinary importance of the stockholder proposal rules to corporate democracy and to badly-needed reform of corporate governance, American stockholders deserve more guidance than the illogical decision of the court below in this case and the *ad hoc* views of harassed middle-level administrative staff—which are "considerably less authoritative" than would be "the definitive views of an agency head."[16] Under present circumstances, stockholders can only get such guidance from this Court. The situation is thus eminently appropriate for exercise of this Court's certiorari jurisdiction.

IV. CONCLUSION

The decision below has broad implications. The topic dealt with is one of fundamental importance. The guidance of this Court is badly needed. The petition for certiorari should be granted.

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[16] *Kixmiller* v. *SEC*, 492 F.2d 641, 644n.13 (D.C. Cir. 1974).

Respectfully submitted,

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